Leeds CITY COUNCIL

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Report of Deputy Chief Executive

Report to Council

Date: 9th November 2016

Subject: TREASURY MANAGEMENT STRATEGY UPDATE 2016/17

Are specific electoral Wards affected? If relevant, name(s) of Ward(s):	☐ Yes	☒ No
Are there implications for equality and diversity and cohesion and integration?	☐ Yes	☒No
Is the decision eligible for Call-In?	☐ Yes	☒ No
Does the report contain confidential or exempt information? If relevant, Access to Information Procedure Rule number: Appendix number:	☐ Yes	☒ No

Summary of main issues

1. This report provides a review and update of the treasury management strategy for 2016/17

2. The Council's level of external debt as at 31st March 2017 is anticipated to be £1,805m, £200m higher than approved in February 2016. This higher forecast borrowing requirement is due to a combination of capital programme injections relating to specific investments and capital investment in service provision, together with a forecast reduction in the level of internal revenue balances that were used to defray external borrowing.

3. In line with the agreed treasury strategy set in February, the Council has taken advantage of lower costs of borrowing by acquiring longer dated debt and thereby reducing exposure to short term fluctuations in the debt markets. The impact together with income generated from strategic investments is a forecast increase in overall debt costs of £0.3m before MRP.

4. The investment of surplus monies will continue to have due regard for security of capital in accordance with the Council's approved investment strategy.

5. The Increase in the level of external debt requires that the Prudential indicators for the Authorised Limit and the Operational boundary to be increased as detailed in section 3.2

Recommendations

That Council:-

6. Note the update on the Treasury Management borrowing and investment strategy for 2016/17.

7. Approve the borrowing limits for 2016/17, 2017/18 and 2018/19 and the changes to both the Operational Boundary and the Authorised limits as set out in Para 3.2.5.

1 Purpose of this report

1.1 The 2016/17 treasury management strategy was approved by Executive Board on 10th February 2016. This report provides a review and update of the strategy for 2016/17.

2 Background information

2.1 The operation of the Treasury Management function is governed by provisions set out under part 1 of the Local Government Act 2003 whereby the Council is required to have regard to the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code for Capital Finance in Local Authorities (amended 2009 and 2011) in particular:

- The Prudential Code requires that full Council set certain limits on the level and type of borrowing before the start of the financial year together with a number of prudential indicators.
- Any in year revision of these limits must be set by Council.
- Policy statements are prepared for approval by the Council at least three times a year.

3 Main issues

3.1 *Review of Strategy 2016/17*

3.1.1 The current borrowing forecasts are shown in Table 1

Table 1

ANALYSIS OF BORROWING 2016/2017		2016/17 Feb 16 Report £m	2016/17 This Report £m
Net Borrowing at 1 April		1,526	**1,620**
New Borrowing for the Capital Programme – Non HRA		124	**174**
New Borrowing for the Capital Programme – HRA		11	**4**
Debt redemption costs charged to Revenue (Incl HRA)		(38)	**(38)**
Reduced/(Increased) level of Revenue Balances		(18)	**45**
Net Borrowing at 31 March*		1,605	**1,805**
Capital Financing Requirement			**2,035**
* Comprised as follows			
Long term borrowing	Fixed	1,254	**1,427**
	Variable (less than 1 Year)	80	**40**
	New Borrowing	79	**185**
Short term Borrowing		202	**181**
Total External Borrowing		1,615	**1,833**
Less Investments		10	**28**
Net External Borrowing		1,605	**1,805**
% borrowing funded by short term and variable rate loans		22%	**22%**

Note: The Capital Financing Requirement (CFR) is the maximum level of debt (i.e. borrowing PFI and finance leasing) that the Council can hold for its current year capital purposes. The Council is also allowed to borrow in advance for up to two future years capital programmes. The above reflects only the borrowing element of the CFR

3.1.2 Table 1 above shows that 2016/17 net external borrowing is now forecast at £1,805m, £200m higher than in the report to Executive Board on 10th February 2016. This higher forecast borrowing requirement is due to a combination of capital programme injections relating to specific investments and capital investment in service provision, together with a forecast reduction in the level of internal revenue balances that were previously used to defray external borrowing. The £200m increase comprises £45m of investment in assets that generate an income stream and £155m of reduced internal balances that were previously used to temporarily defray external borrowing. Of this £92m of reduced revenue balances were reported in the 2015/16 Outurn Treasury 2015/16 report to June Executive Board. The main reductions have now been identified as £35m of HRA balances, £25m capital grants unapplied and £34m net working capital. A further £63m reduction in internal balances in now forecast. These balances will continue to be monitored through the year.

3.1.3 The economic outlook remains one of subdued growth across many of the major economies. The slowdown in China and emerging markets is continuing with medium terms risk to the Chinese economy beginning to emerge. The Japanese economy continues to be supported by further tranches of Quantitative Easing (QE) and in Europe a package of €1.1 trillion QE was begun in March 2015. The programme was implemented at €60 billion of purchases per month which was increased in March 2016 to €80 billion per month. The European Central Bank has also cut its deposit rate to minus 0.4%. This has reduced the cost of borrowing but growth, although positive is 1.6% annualised in Q2. This has added to comments from many forecasters that central banks around the world are running out of ammunition to stimulate economic growth and to boost inflation. They stress that national governments will need to do more by way of structural reforms, fiscal measures and direct investment expenditure to support demand in the their economies and economic growth.

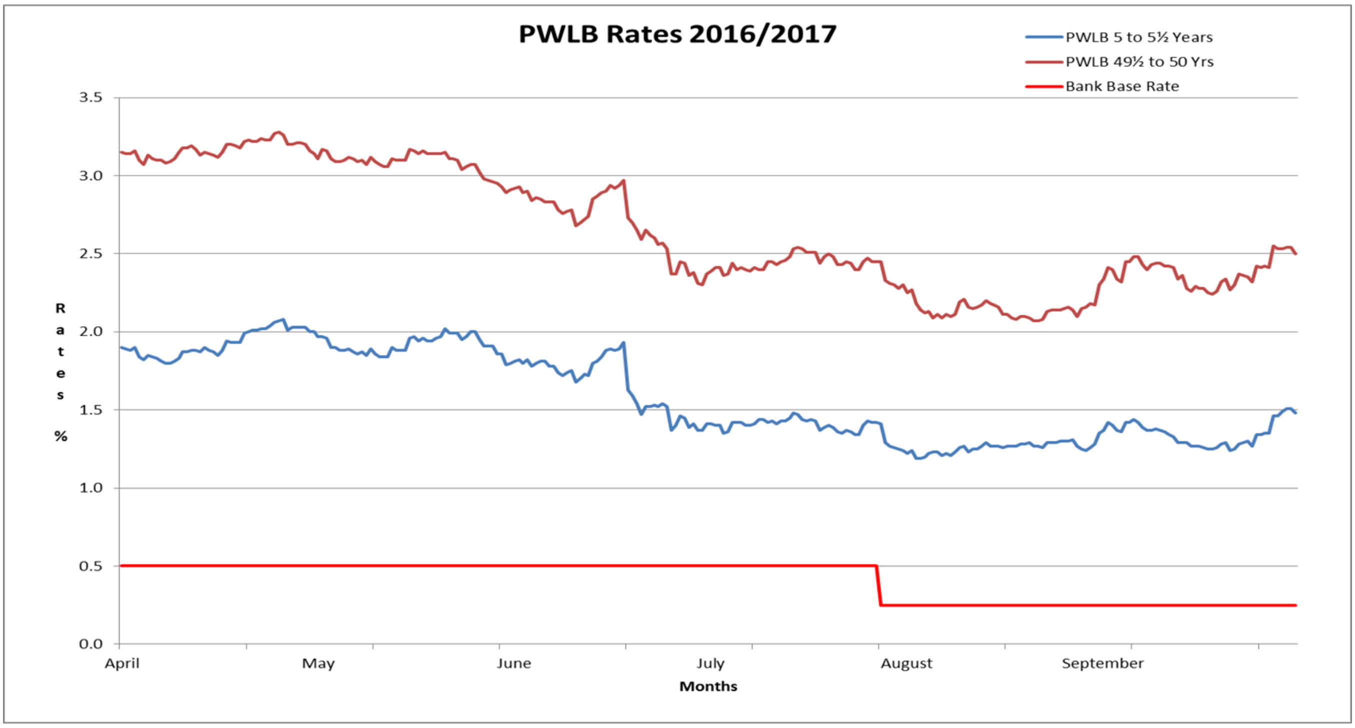
3.1.4 In the US Q2 growth improved to 1.4% The Federal Reserve raised rates for the first time since the 2008 crash in December 2015. This was thought at the time to be the first of a series of steady increases during 2016 however International factors have caused the Fed to pause. Many commentators now expect the next increase to be in December 2016.

3.1.5 The UK Q2 growth was 0.7% (2.1% Y/Y). The Bank of England (BoE) estimates growth for 2016 to be in the region 2% however growth forecast for 2017 has been cut from 2.3% to 0.8% due to the outcome of the vote on European membership (Brexit). Similarly the BoE is also forecasting a sharp rise in inflation to 2.40% with the CPI inflation rate for September reaching 1.0% after being at or close to 0% through 2015. It should be noted that immediately following the Brexit vote, confidence and business survey indicators pointed to a significant slowdown however these indicators quickly recovered. However Sterling has continued to fall against the Dollar and Euro and is 18% below its pre-Brexit level when measured against other major currencies. Further falls are expected.

3.1.6 Increased oil prices will feed into higher inflation expectations above the 2% MPC target but economists predict that the MPC will regard this as temporary and not alter the base rate for this reason alone.

3.1.7 Chart 1, shows how the cost of longer term borrowing from the Government through PWLB loans has performed since the start of the financial year. The 5 year to 5½ Year PWLB has moved upwards from a starting point of 1.90% to a high of 2.08% at the end of April before falling to a low point in August of 1.19%. It is currently in the region of 1.5%. Similarly, the 49½-50 year PWLB has moved from a starting point in April of 3.15% to a high of 3.28% in late April before falling to a low point in August of 2.07% this rate is currently in the region of 2.50%. The Council is entitled to a reduction of 20bp on all PWLB rates reflecting eligibility for PWLB certainty rates.

Chart 1



3.1.8 Given the outlook for domestic and international economic growth, the prospects for any interest rate changes before mid-2018 are limited. There is potential for the start of Bank Rate increases to be even further delayed if growth continues to be subdued and inflation factors do not materialise or are deemed to be temporary in nature. The latest forecast of rates is shown in table 3 below.

Table 3

13/10/2016	Now	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
BANK RATE	0.25	0.10	0.10	0.10	0.10	0.10	0.10	0.25	0.25	0.25	0.25	0.50
3 month LIBID	0.50	0.20	0.20	0.20	0.20	0.20	0.30	0.30	0.30	0.40	0.50	0.60
6 month LIBID	0.55	0.30	0.30	0.30	0.40	0.40	0.50	0.50	0.50	0.60	0.60	0.70
12 month LIBID	0.75	0.50	0.50	0.60	0.60	0.70	0.70	0.70	0.80	0.80	0.80	0.90
5 yr PWLB	1.26	1.00	1.00	1.10	1.10	1.10	1.10	1.20	1.20	1.20	1.20	1.30
10 yr PWLB	1.85	1.50	1.50	1.60	1.60	1.60	1.60	1.70	1.70	1.70	1.70	1.80
25 yr PWLB	2.56	2.30	2.30	2.40	2.40	2.40	2.40	2.50	2.50	2.50	2.50	2.60
50 yr PWLB	2.36	2.10	2.10	2.20	2.20	2.20	2.20	2.30	2.30	2.30	2.30	2.40

3.1.9 Expectations for the first change in Bank Rate in the UK have slowly been pushed back during the year as the wider economic picture has emerged and the first increase is now not expected until Q2 2018 from its new low of 0.25%. As a result the following table shows the revised forecast interest funding assumptions

Table 4

Budget Rate Assumptions	2016/17	2017/18	2018/19	2019/20	2020/21
Exec Board Feb 16	0.60	1.00	1.50	2.25"	3.00"
Now	0.50	0.50	0.75	0.75	1.00

* provisional assumption

3.1.10 The current borrowing strategy continues to fund the borrowing requirement of the capital programme from short dated loans and internal cash balances. There will come a point when rates begin to rise and more expensive longer dated funding will be required, even though this continues to be pushed further back as the economic outlook evolves. The Deputy Chief Executive will continue to monitor market dynamics with a view to securing longer term debt at the appropriate time.

3.1.11 The current strategy also allows for taking advantage of lower longer-term funding to manage the Council's exposure to fluctuations in funding costs. Table 2 below details the long term funding activity undertaken during 2016/17 which consists of £100m of new PWLB funding as volatility in the markets during the summer caused a succession of new lows to be reached. Additionally £10m of LOBO loans were rescheduled with a lender under which a rate reduction was achieved together with an extension to the non-call period and a change to the call options from 1 month to 5 years in exchange for an extension to the final maturity of the loans.

Table 2

Rescheduling and Funding 2016/17							
Premature Repayments				**New Replacement Borrowing**			
Date	**Amount (£m)**	**Original Rate (%)**	**Discount Rate**	**Date**	**Amount (£m)**	**Term (Years)**	**Interest Rate (%)**
PWLB				PWLB			
				03/06/2016	20	50	2.78%
				08/06/2016	20	47	2.68%
				17/06/2016	20	49	2.55%
				28/06/2016	20	49	2.49%
				05/07/2016	20	49	2.15%
Sub Total	**0**				**100**		
LOBOs				LOBOs			
01/09/2016	2.5	3.99%	n/a	01/09/2016	2.5	60	3.65%
01/09/2016	7.5	3.99%	n/a	01/09/2016	7.5	60	3.65%
Sub Total	**10**				**10**		
Total	**10**			**Total**	**110**		

3.1.12 The strategy of deferring long term borrowing will increase the amount of debt that the Council is funding from short term loans and its balance sheet to a forecast £568m. This exposure is considered manageable given historical capital programme slippage, the continued strength of the Council's balance sheet and the market for supplying short term funds remaining strong. These factors will continue to be monitored and should be considered in the context of the stability of the current debt maturity profile.

3.1.13 To mitigate against the exposure to rising interest rates the Council is exploring a number of forward funding options which will give the Council the ability to lock in future funding at current rates.

3.1.14 The Council's current long term debt of £1.467bn has an average maturity of just over 39 years if all debts run to maturity. Approximately 30% of the Council's debt has options for repayment, in the unlikely event that all these options were exercised at the next option date then the average maturity of long term debt would be lowered to 23½ years. This compares favourably with the average maturity of the UK Government debt portfolio of nearly 14 years. The existing profile of the Council's debt provides considerable certainty of funding costs. Prudential Indicator 16 in Appendix A shows the maturity profile of the Council's long term fixed debt and highlights that 58% or £818m matures in periods greater than 10 years.

3.1.15 Short term debt at low rates of interest and existing revenue balances continue to be used to fund the borrowing requirement, however long term funding activity described in 3.1.11 has resulted in additional costs against budget of £1.5m offset by additional income generated from the investment in strategic assets. The net impact is a forecast increase in overall debt costs of £0.3m before MRP.

3.2 Borrowing Limits for 2016/17, 2017/18 and 2018/19

3.2.1 The Council is required to set various limits for 2016/17, 2017/18 and 2018/19 in accordance with the Local Government Act 2003, having regard for CIPFA's prudential code (as amended 2009 and 2011). These limits including prudential indicators are detailed in Appendix A.

3.2.2 The Deputy Chief Executive has delegated responsibility to make adjustments between the two separate limits for borrowing and other long term liabilities, provided that the overall limit remains unchanged. Any such adjustments will be reported to the next available Council meeting following the change. It is recommended that Council approve the following authorised limits for its gross external debt and other long term liabilities for the next three years.

3.2.3 After reviewing the forecast debt and borrowing position together with the forecast reduction in revenue balances as highlighted in 3.1.2, the Limit for borrowing is recommended to be increased as follows. For 2016/17 the limit should be increased from £1,900m to £2,100m, for 2017/18 the limit should be increased from £1,900m to £2,100m. For 2018/19 the limit should be increased from £1,950m to £2,100m. The limit for Other Long Term Liabilities is recommended to remain the same for the years 2016/17 to 2018/19 as detailed below.

Recommended: Authorised Limits as follows

Authorised Limit	**2016/17 £m**	**2017/18 £m**	**2018/19 £m**
Borrowing	2,100	2,100	2,100
Other Long Term Liabilities	760	740	720
Total	**2,860**	**2,840**	**2,820**

3.2.4 In line with the above review of the authorised limits above it is proposed to amend the operational boundaries as detailed below. This limit will retain sufficient headroom to accommodate anticipated cashflow variances. For 2016/17 the limit should be increased from £1,750m to £1,930m, for 2017/18 the limit should be increased from £1,800m to £1,970m and for 2018/19 the limit should be increased from £1,850m to £2,010m. The limit for Other Long Term Liabilities is recommended to remain the same for the years 2016/17 to 2018/19 as detailed below.

Recommended: Operational Boundaries as follows

Operational Boundary	**2016/17 £m**	**2017/18 £m**	**2018/19 £m**
Borrowing	1,930	1,970	2,010
Other Long Term Liabilities	740	720	700
Total	**2,670**	**2,690**	**2,710**

3.2.5 Table 5 below details the borrowing element of the Authorised Limit and Operational Boundary and compares this to the projected CFR for borrowing only and does not include Other Long term Liabilities. The revised Operational Boundary remains below the projected CFR however Authorised limit is set above the CFR projection for 16/17 as this gives scope to fund future year's capital programme borrowing in advance of need if market circumstances are favourable. The CFR is the Councils actual need to borrow based on its historic capital programme and forecast future capital programme. The increase in these limits and boundaries are to reflect a prudent safety margin in light of actual and expected changes in both the level of the Councils revenue balances and it on-going capital programme.

Table 5

year	2016/17 £m	2017/18 £m	2018/19 £m
Borrowing only			
CFR Projection.	2,035	2,161	2,199
Authorised Limit			
Current	1,900	1,900	1,950
Proposed	2,100	2,100	2,100
Increase / (Decrease)	200	200	150
Operational boundary			
Current	1,750	1,800	1,850
Proposed	1,930	1,970	2,010
Increase / (Decrease)	180	170	160

3.3 Investment Strategy & Limits

3.3.1 The Council's external debt is reduced by the availability of revenue balances. The Treasury policy also allows for the external investment of these balances at advantageous rates but with due regard for security of capital invested. At present the Council's surplus monies continue to be held in short periods until required except for £20m which has been invested in 364 day period at an average of 0.97% with excellently rated banks. As market sentiment to counter-party risk improves, together with enhanced returns, surplus monies will be invested in accordance with the approved lending list. This lending list is based upon the assessment of the financial standing of counterparties as determined by international credit rating agencies and further refined and updated by the Council's advisors on a continual basis. The lending list is often further restricted based upon the Council's view of the credit worthiness of counter-parties.

3.3.2 The investment strategy, as re-affirmed by Executive Board and full Council in February, allows for the Council to invest in only the most highly rated financial institutions around the world. The Council will only lend up to a maximum of £15m to financial institutions that are rated as excellent. There is also a limit of £5m for financial institutions that are rated as very good.

4 Corporate Considerations

4.1 Consultation and Engagement

4.1.1 This report is an update on strategy as presented to Executive Board in February 2016, as such no consultation has taken place. However, consultation with the Council's treasury advisors takes place regularly throughout the year.

4.1.2 The borrowing requirement is an outcome of the capital programme. Consultation is undertaken by individual services in relation to capital investment schemes. A capital programme update report is included elsewhere on this agenda.

4.2 Equality and Diversity / Cohesion and Integration

4.2.1 Equality, diversity, cohesion and integration requirements are addressed as part of individual capital scheme and programme approvals. The borrowing to deliver these capital schemes is executed through treasury strategy and as such there are no further equality diversity cohesion and integration issues.

4.3 Council policies and Best Council Plan

4.3.1 Treasury Management strategy secures funding to support the Council's Policies and City Priorities as set out in the Council capital programme and is consistent with the Best Council Plan.

4.4 Resources and Value for Money

4.4.1 This update on the treasury strategy recognises the borrowing necessary to fund the capital programme requirements of both General Fund and HRA. Where borrowing is supported the revenue costs are met by the Government, whilst for unsupported borrowing revenue costs are met either by the General Fund or HRA.

4.4.2 The updated strategy 2016/17 is forecast to incur additional costs of £1.5m against the budgeted position mainly due to taking higher rate longer dated funding than was anticipated in the budget as part of the agreed strategy to lock out financing risk as opportunities arise. The impact together with income generated from strategic investments is a forecast increase in overall debt costs of £0.3m before MRP.

4.5 Legal Implications, Access to Information and Call In

4.5.1 There are no legal, or access to information issues arising from this report. The report is not subject to call in.

4.6 Risk Management

4.6.1 This report sets out the framework for the treasury strategy for the year ahead. The execution of strategy and associated risks are kept under regular review through:

- Monthly reports to the Finance Performance Group
- Quarterly strategy meeting with the Deputy Chief Executive and the Council's treasury advisors
- Regular market, economic and financial instrument updates and access to real time market information

4.6.2 The above monitoring mitigates the directorate level risk of "Failure to recover money invested in other financial institutions" and in addition the Treasury Management Strategy is linked to the corporate risk on 'Financial Forecasting'.

5 Conclusions

5.1 The Council's level of net external debt at 31st March 2017 is anticipated to be £1,805m, £200m higher than expectations in February 2016.

5.2 Treasury Management activity has Incurred additional costs against budget of £1.5m. This is largely due to taking higher rate longer term funding at attractive rates in comparison to the budget provision. The impact together with income generated from strategic investments is a forecast increase in overall debt costs of £0.3m before MRP.

5.3 The Increase in the level of external debt requires that the Prudential Indicators for the Authorised Limit and the Operational boundary be increased as detailed in section 3.2

6 Recommendations

That Council:-

6.1 Note the update on the Treasury Management borrowing and investment strategy for 2016/17.

6.2 Approve the borrowing limits for 2016/17, 2017/18 and 2018/19 and the changes to both the Operational Boundary and the Authorised limits as set out in Para 3.2.5.

7 Background documents1

None

[1] The background documents listed in this section are available to download from the Council's website, unless they contain confidential or exempt information. The list of background documents does not include published works

Appendix A

Leeds City Council - Prudential Indicators 2016/17 - 2018/19

No.	PRUDENTIAL INDICATOR	2016/17	2017/18	2018/19
	(1). EXTRACT FROM BUDGET AND RENT SETTING REPORTS			
	Ratio of Financing Costs to Net Revenue Stream			
1	General Fund - Excluding DSG (Note1)	13.68%	16.68%	18.07%
2	HRA	10.58%	11.35%	11.44%
	Impact of Unsupported Borrowing on Council Tax & Housing Rents	**£ . P**	**£ . P**	**£ . P**
3	increase in council tax B7(band D, per annum) (Note 2)	16.31	58.00	89.51
4	increase in housing rent per week	0.03	0.33	0.69
5	Net Borrowing and the capital financing requirement (Note 3)	OK	OK	OK
	Estimate of total capital expenditure			
6	Non HRA	302,237	237,217	141,962
7	HRA	139,269	129,693	96,036
	TOTAL	441,506	366,910	237,998
	Capital Financing Requirement (as at 31 March)	**£'000**	**£'000**	**£'000**
8	Non HRA	1,846,732	1,923,885	1,944,362
9	HRA	825,380	849,412	843,538
	TOTAL	2,672,112	2,773,297	2,787,900
9a	**Limit of HRA Indebtedness as implemented under self financing**	725,327	725,327	725,327

No.	PRUDENTIAL INDICATOR	2016/17	2017/18	2018/19
	(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	**£'000**	**£'000**	**£'000**
10	**Authorised limit for external debt - (Note 5)**			
	borrowing	2,100,000	2,100,000	2,100,000
	other long term liabilities	760,000	740,000	720,000
	TOTAL	2,860,000	2,840,000	2,820,000
11	**Operational boundary - (Note 5)**			
	borrowing	1,930,000	1,970,000	2,010,000
	other long term liabilities	740,000	720,000	700,000
	TOTAL	2,670,000	2,690,000	2,710,000
14	**Upper limit for fixed interest rate exposure**			
	expressed as either:-			
	Net principal re fixed rate borrowing / investments OR:-	115%	115%	115%
	Net interest re fixed rate borrowing / investments			
15	**Upper limit for variable rate exposure**			
	expressed as either:-			
	Net principal re variable rate borrowing / investments OR:-	40%	40%	40%
	Net interest re variable rate borrowing / investments			
17	**Upper limit for total principal sums invested for over 364 days (Note 5**	150,000	150,000	150,000
	(per maturity date)			
18	**Net Debt as a percentage of Gross debt**	98.5%	99.6%	99.6%

16	**Maturity structure of fixed rate borrowing as at 31/03/2016**	**Lower Limit**	**Cumulative Upper Limit**	**Projected 31/03/2017**
	under 12 months	0%	15%	0.00%
	12 months and within 24 months	0%	20%	13.56%
	24 months and within 5 years	0%	35%	19.24%
	5 years and within 10 years	0%	40%	9.24%
	10 years and within 20 years			1.77%
	20 years and within 30 years			0.00%
	30 years and within 40 years	25%	90%	34.13%
	40 years and within 50 years			22.07%
	50 years and above			0.00%
				100%

Notes.

1 **The indicator for the ratio of financing costs to net revenue stream for General Fund is now calculated based on the Net Revenue Charge less the Dedicated Schools Grant (DSG). The Government changed the funding of education to DSG from 2006/07.**

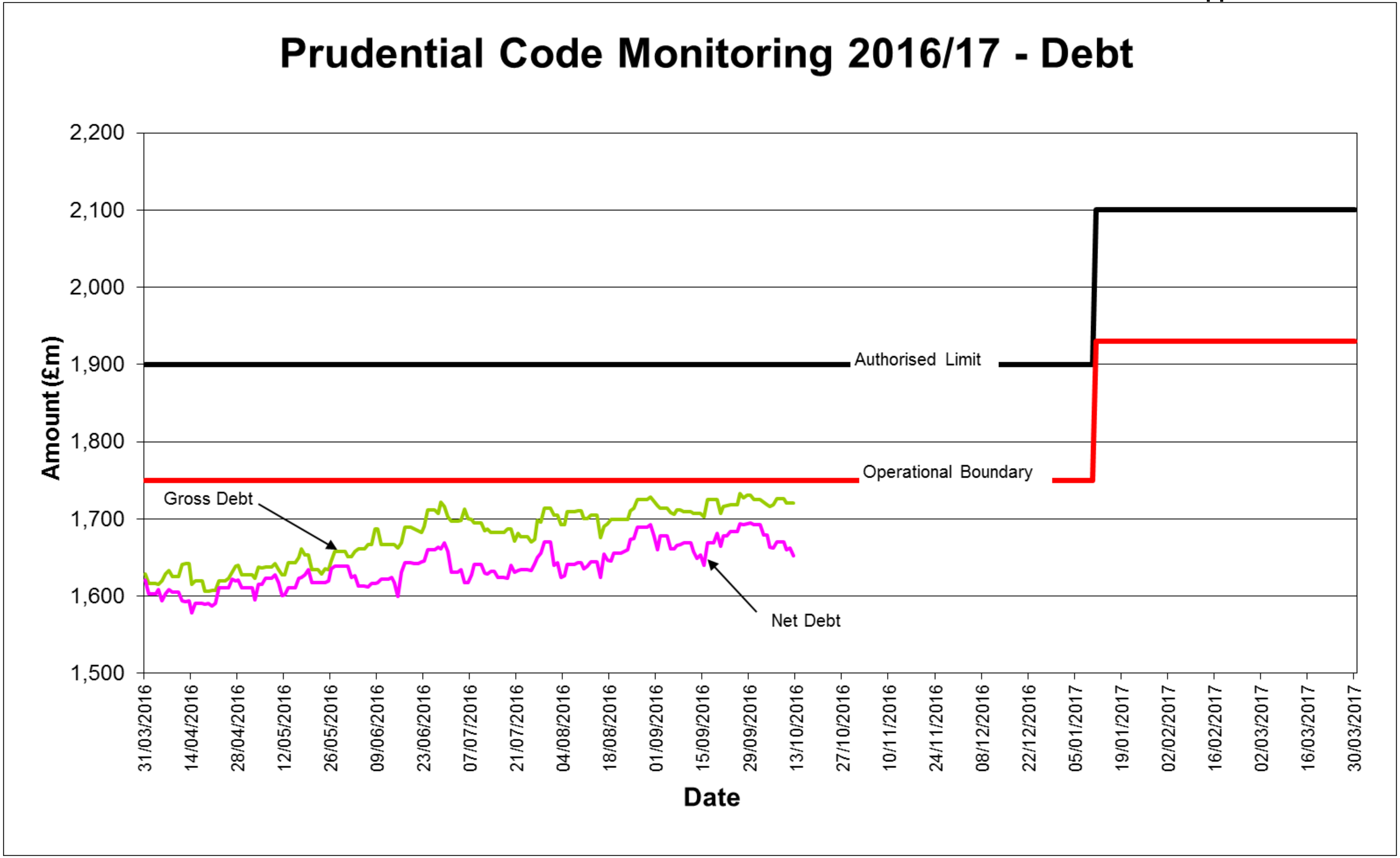
2 **The code requires that the Council identifies the capital financing costs arising from unsupported borrowing expressed as the amount per band D property.**

3 **In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Council should ensure that net external borrowing does not exceed the total capital financing requirement in the preceding year plus estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.**

4 **Prudential indicator 12 relates to actual external debt at 31st March, which will be reported in the Treasury Management Annual Report.**

5 **Prudential indicator 13 relates to the adoption of the CIPFA Code of Practice on Treasury Management. The Council formally adopted this Code of Practice in March 2003, and the revised code in Frebruary 2010 and 2012**

Appendix B


Prudential Code Monitoring 2016/17 - Debt
Amount (£m)
2,200
2,100
2,000
1,900
1,800
1,700
1,600
1,500
Authorised Limit
Operational Boundary
Gross Debt
Net Debt
31/03/2016
14/04/2016
28/04/2016
12/05/2016
26/05/2016
09/06/2016
23/06/2016
07/07/2016
21/07/2016
04/08/2016
18/08/2016
01/09/2016
15/09/2016
29/09/2016
13/10/2016
27/10/2016
10/11/2016
24/11/2016
08/12/2016
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16/02/2017
02/03/2017
16/03/2017
30/03/2017
Date